

Executive summary

Official KZT/USD exchange rate as at 01.01.08 was 120.30

Economy

- Economic growth continued in 2007, however at a slower pace
- Construction appeared to be the most vulnerable sector of the economy in respect of liquidity issues in the banking sector
- Government support has financed the construction sector in Astana
- Strengthening of the Kazakh tenge against the US Dollar

Banking Sector

- Deposit inflows into the banking sector recommenced
- Despite the complex situation in the financial sector, the interest of international investors in Kazakh banks remained high
- The National Bank intends to support the banking sector in 2008

Kazakhstan's Economy

Economic growth in Kazakhstan was 8.7 per cent in 2007

During the last eight successive years Kazakhstan's economy developed rapidly, with an average annual rate of real GDP growth between 2000 and 2007 of 10 per cent. The main external growth factor during recent years has been high commodity prices, primarily for oil and metals.

Based on preliminary data, real GDP growth in Kazakhstan in 2007 was 8.7 per cent, resulting from increased production in all sectors of the economy. Thus, during the first eleven months of 2007 industrial production grew by 4.5 per cent, agricultural production by 8.5 per cent, trade by 10 per cent and transport services by 4.7 per cent. Agriculture in particular made a significant contribution to economic growth in 2007, as a result of a large grain harvest and global grain prices. In consequence, the gross agricultural output for the first time exceeded KZT 1 trillion.

However, economic growth in 2007 was lower than expected. The lower GDP growth rate was related to insufficient liquidity experienced by commercial banks due to limited opportunities to raise external funds. As a result, commercial banks considerably reduced lending to industrial enterprises.

Against a background of high world commodity prices, Kazakhstan's foreign trade turnover increased by 27.6 per cent during the first ten months of 2007 compared to the same period in 2006, including increases in exports and imports of 19.6 per cent and 40.8 per cent, respectively.

In 2007 wages and per capita incomes of the population continued to grow rapidly. According to official statistics, the average monthly wage in the period January to September 2007 represented KZT 50,469, while income per capita was KZT 24,902, i.e. USD 400 and USD 200, respectively. However, increasing inflation and consumer prices have inhibited noticeable improvements in the quality of life of the population in Kazakhstan.

Conditions in the construction sector have changed significantly: Decreases in construction volumes and real estate prices

Over the last three years real estate prices have increased rapidly. According to official data, in August 2007, compared to the previous year, the real income of the population increased by 12.7 per cent and real wages by 17 per cent. During the same period, the price per square meter of housing stock increased 1.7 times. Despite this fact, the demand for housing stock remained high until August 2007, spurred on by the accessibility of mortgage loans. A major proportion of housing stock was purchased for investment purposes with the aim of achieving capital appreciation rather than with the purpose of improving housing conditions.

However the situation in the construction sector has fundamentally changed since August 2007. As a result of the global liquidity crisis, the access of some Kazakh banks to international funding had been limited, resulting in reduced volumes and stricter terms for credit transactions. Under these conditions construction companies found themselves under pressure from two sides : financing from banks was restricted and the volume of solvent demand from customers fell due to a reduction in mortgage lending. In the first ten months of 2007, the value of construction work represented KZT 1085.8 billion , 13.2 per cent

higher than in the period January to October 2006, while the equivalent figure for the first nine months had been 26.2 per cent higher and the value of construction work in the period January to July was always more than 30 per cent higher than in 2006. In addition real estate prices fell substantially throughout the country and analysts believe this trend will continue in 2008.

Government support for construction sector

The Government has made action to support stable social and economic development a high priority, including measures to stabilise the mortgage market, to protect the rights of shareholders in construction projects and to complete construction programmes. As a consequence, construction companies have begun to receive financing for completion of unfinished projects in Astana. Kazyna Fund submitted information on 112 unfinished construction projects to the state commission, which approved financial support: 85 per cent of the costs will be financed by Kazyna Fund, 10 per cent from the bank and 5 per cent from the construction company. Currently, funds for 52 out of 112 projects have been deposited with second-tier banks. For instance, Bank TuranAlem received a three-year deposit of KZT 9.8 billion (USD 81 million) from the Kazyna Fund and a three-year deposit has also been placed with Kazkommertsbank. Having refinanced the construction sector in Astana, the Government plans a similar financing program in Almaty.

Moreover, the State development programme for residential housing helped to create 17.4 million square meters of housing between 2005 and 2007 instead of the planned 15.8 million square meters. The new programme for 2008 to 2010 was approved last year, to provide housing for low-income groups.

In 2007 inflation reached its peak for the last 5 years

Inflation trends in December 2007 remained the same as in November and October 2007, with prices for food products growing especially rapidly. High rates of inflation in the last three months of 2007 affected such food products as bread, flour and sunflower-seed oil because of major price increases for these products in the global market.

The influence of monetary factors on price growth was minimal. Money supply growth in January-December 2007 was moderate at 22.9 per cent, which was lower than the nominal GDP growth rate. The cash base in January-December 2007 decreased by 2.5 per cent compared to an increase of 126.4 per cent in January-December 2006. The monetary multiplier for 2007 increased from 2.4 to 3.0, representing a non-inflationary contributor to the money supply.

| <i>Macroindicators</i> | <i>Dec 2007</i> | <i>Jan-Dec 2007</i> | <i>Jan-Dec 2006</i> |
|---------------------------------|-----------------|---------------------|---------------------|
| Inflation rate, % | 1.9 | 18.8 | 8.4 |
| Prices for food products | 2.7 | 26.6 | 7.3 |
| Prices for non-food products | 1.2 | 10.5 | 7.1 |
| Prices for paid services | 1.3 | 15.4 | 11.6 |

Source: National Bank of Kazakhstan

The main objective for the Government of Kazakhstan in 2008 will be to implement its anti-inflation policy. According to the statement made by the Prime Minister of Kazakhstan, Mr. Karim Masimov, price control and regulation of public utility costs will be a priority of economic policy, including control of price increases for the main food products, public utility charges and gasoline prices.

The Government of Kazakhstan has formed working groups on regulating the situation in the local market, and price stabilisation for oil products and foodstuffs. The Government will continue the commercial purchase of grain to stabilise the food products market. In general, food imports will be liberalised by customs exemptions.

Net international reserves of the National Bank reduced

The net international reserves of the National Bank fell due to foreign currency sales on the domestic market, external debt servicing for the Ministry of Finance and reduced foreign currency balances of the commercial banks on correspondent accounts with the National Bank. In contrast, gold assets grew due to the increase in global gold prices by 30.3 per cent. In general, international reserves, including assets of the National fund (USD 21.0 billion), grew as well, due to the high growth rates of global crude oil prices.

| | 2007 | % change in 2007 | million USD As at 15.01.2008 |
|--|---------------|---------------------|------------------------------------|
| Net international reserves of the National Bank | 17,389 | -9.1 | 18,451 |
| including | | | |
| Net assets in currency | 15,537 | -12.5 | 16,463 |
| Gold | 1,852 | 34.6 | 1,988 |
| International reserves of the country | 38,438 | 15.7 | 39,755 |

Source: National Bank of Kazakhstan

Nominal KZT/USD exchange rate strengthened in 2007

Inflow of significant income from oil production as a result of high global crude oil prices contributed to the balance of supply and demand for the US Dollar in the domestic currency market. As a result, in 2007 there was a 2.5 per cent appreciation of the tenge against the US Dollar. During 2007 the KZT/USD exchange rate varied between 122.55 and 124.74 KZT per USD.

Additionally, the USD fall in global currency markets also affected the Dollar in Kazakhstan. In particular, the fall in USD was confirmed in the autumn of 2007 when the US Federal Reserve System decreased interest rates from 5.25 per cent to 4.5 per cent.

Key developments in the economy of Kazakhstan

- **Kuat Corporation and BI-Group received KZT 500 million each by the end of 2007** to complete their construction projects in the city of Astana. The funds have been received via commercial banks at an interest rate of 14 per cent. According to some sources, the programme devoted to financing incomplete construction in Almaty comprises the following construction companies: BI Group, Bazis, Vek Corporation and Kuat Corporation.

- **Bank TuranAlem received KZT 12.2 billion** (about USD 100 million) to participate in the programme to support small and medium enterprises. Kazkommertsbank and other Kazakh banks also received funds from the programme.

- **Fitch Ratings changed the outlook on Kazakhstan sovereign ratings.** The outlook on the long-term issuer default rating of Kazakhstan has been changed from “Stable” to “Negative”. At the same time, Fitch has affirmed Kazakhstan's Long-term foreign currency IDR at 'BBB' and the Long-term local currency IDR at 'BBB+'. The rating action reflects Fitch's revised assessment of the risks to Kazakhstan's sovereign credit profile arising from a severe curtailment in the Kazakh banking sector's access to international capital markets since August 2007. According to the Fitch analysts, the persistence of difficult market conditions has increased the risk that Kazakh borrowers may struggle to attract foreign capital well into 2008, which could prolong the draw-down on foreign exchange reserves and widen the scope for external liquidity problems to spill over into a broader threat to financial stability.

- **Kazakh Mortgage Company (KMC) is to receive an amount of KZT 20.5 billion from the government**, out of which KZT 8.5 billion will be directed to increase the authorised capital, and KZT 12 billion in the form of long-term debt for 20 years. Funds will be used to stabilise the domestic mortgage market. Furthermore, KMC signed a loan agreement with Credit Suisse investment bank for the amount of

USD 100 million.

- **Kazakhstan increased production of oil and gas condensate by 3.7 per cent in 2007.** In 2007 the volume of oil and gas condensate production in Kazakhstan, according to preliminary data, was 67.3 million tons, which is 3.7 per cent more compared to 2006. Gas condensate production was 6.3 million tons (an increase of 109.6 per cent compared to 2006).

- **The share of the national KazMunaiGaz oil and gas company in the Kashagan project will increase from 8.33 per cent to 16.81 per cent.** According to the Memorandum of Understanding signed recently Kazakhstan will buy an additional share from existing shareholders on a pro rata basis. The price to be paid for the additional share will amount to USD 1.78 billion.

The banking sector in Kazakhstan

Inflow of deposits into banks recommenced; moderate growth of assets and loans to customers

| <i>Banking system indicators *</i> | million. USD | | | |
|------------------------------------|-------------------|-------------------|------------------------|------------------------|
| | <i>01.12.2007</i> | <i>01.01.2008</i> | <i>December growth</i> | <i>Growth for 2007</i> |
| Assets | 95,495 | 96,877 | 1.4 | 38,6 |
| Loans to customers | 71,438 | 72,006 | 0.8 | 61,4 |
| Customer accounts | 31,093 | 32,383 | 4.1 | 29,6 |
| Retail deposits | 11,783 | 12,010 | 1.9 | 47,5 |
| Equity | 11,571 | 11,803 | 2.0 | 70.4 |

* Preliminary data

The situation in Kazakhstan's banking sector in December 2007 did not change significantly as compared to November 2007. Despite continued uncertainty in international financial markets and decreases in international lending, loans to customers and bank equity in December demonstrated moderate growth. Inflows of retail deposits to banks recommenced in November 2007 and continued within the reporting period. Absolute growth of deposits in December amounted to USD1,290 million (compared to USD 192.6 million in November, at a KZT/USD exchange rate of 120.87).

Despite the decrease in retail deposits during the 3rd and 4th quarter of 2007, the trend since the beginning of the year remained positive, and the share of retail deposits in total customer accounts increased from 32.6 per cent to 37.1 per cent. Term deposits remained dominant and comprised 86.6 per cent of retail deposits. This confirms the confidence of the population in the banking system. Taking into account the situation in international debt markets banks will have to start aggressive policies to attract funds from local market, including efforts to increase retail deposits.

Starting from 2007 and due to the global liquidity crisis, bank liquidity ratios have been declining, but continue to comply with requirements by a comfortable margin. Thus, as at January 1, 2008, according to Kazkommertsbank estimates, the immediate liquidity ratio, showing the ability of banks to meet demand obligations, were the following: BTA – 96.4 per cent (where the optimal level is 30-50 per cent), Kazkommertsbank - 59 per cent, Halyk Bank – 32 per cent, Alliance Bank – 83 per cent and ATF Bank – 139 per cent. Taking into account that the share of these five banks in the total assets of the Kazakh banking sector is about 80 per cent, the overall stability of the Kazakh banking sector reflects their financial position.

Concentration in the Kazakh banking sector remains quite high due to a relatively high concentration of borrowers and active involvement in the real estate and construction sectors. As at December 1, 2007, 9.1 per cent of the total loan book of the banks was to the industrial sector, 17.5 per cent to trade, and 17.3 per cent to construction. The exposures to construction of Kazakh banks reflected unpredictable development of the sector. Doubtful loans as a percentage of total construction exposures grew for the first 9 months of 2007 from 20.5 per cent to 72 per cent.

According to National Bank of Kazakhstan data, commercial banks during the course of 2008 will have to redeem foreign borrowings for the total amount of USD 12 billion, USD 9 billion of which represent the principal amount and the remaining USD 3 billion is accrued interest. These amounts are distributed

irregularly during the course of the year, while the majority of loans are due in the second half of 2008.

Major events in the Kazakh banking sector

• **Despite the complicated financial situation, the local banking sector remains attractive for foreign investors**

- The daughter bank in Kazakhstan of JSC Sberbank of Russia increased its charter capital by 14.5 times to KZT 29 billion;

- Demir Kazakhstan Bank increased its charter capital by 80 per cent up to KZT 4 billion. Turkish BankPozitif acquired newly issued common shares of Demir Kazakhstan Bank. By the end of January 2008 they plan to change the name of the bank to Bank Pozitif;

- JSC "DJCB "ABN AMRO Bank Kazakhstan" increased its charter capital up to KZT 8.3 billion, as a result of an additional share placement of KZT 6,48 billion. Shares were placed among the existing shareholders of the bank, ABN AMRO Bank N.V. and the International Finance Corporation.

- The South Korean Shinhan Bank has submitted an application to the Kazakh FMSA to open a daughter bank in Kazakhstan.

- During the course of 2008 the Russian VTB Bank is planning to open a representative office in Kazakhstan.

• **Commercial banks continue to raise and repay loans**

- German development bank DEG and National City Bank (USA) have extended loans to Bank CenterCredit of USD 40 million, and USD 30 million, respectively. Bank CenterCredit repaid a matured syndicated loan of USD 266.1 million.

- Kazkommertsbank repaid an A tranche of the syndicated loan signed in December 2006 for USD 1 billion. The maturing and repaid part of the loan amounted to USD 700 million. A framework agreement was signed with the Islamic Development Bank for USD 50 million, with the purpose of financing medium and long term projects.

- JSC "Eurasian Bank" repaid a matured syndicated loan of USD 70 million.

- BTA has entered into a loan agreement with German DEG for USD 82 million.

• **Other news from the banking sector**

- The National Bank of Kazakhstan will continue to support commercial banks in respect of their short-term liquidity in 2008. Additionally, the National Bank of Kazakhstan has postponed the date of implementation of minimum reserve requirements for commercial banks (5 per cent for internal obligations and 10 per cent for other obligations) from January 15, 2008 to July 01, 2008 in order to regulate the short-term liquidity. The National Bank has maintained an 11 per cent refinancing rate from January 01, 2008.

- The Financial Markets Supervisory Agency has increased requirements for size of bank capital. Changes to the size of bank reserve capital will be introduced in May 2008: reserve capital must be not less than 2 per cent of the loan portfolio of the bank. Moreover, starting from January 1, 2009 banks should increase minimum equity capital to KZT 1.5 billion and from January 1, 2010 to KZT 2 billion. (The existing minimum equity capital is KZT 1 billion.) At the same time, starting from January 1, 2009 existing requirements limiting long term foreign borrowings (k8 and k9) will change: k8 from 4 to 2.5 and k9 from 6 to 5.

- Standard & Poor's has changed the outlook for issuer credit rating from "Stable" to "Negative" for eight Kazakhstan banks: JSC Kazkommertsbank, JSC BankTuranAlem, JSC Halyk Bank, JSC Alliance Bank, JSC Temirbank, JSC Nurbank, JSC Eurasian Bank, and for the subsidiary of JSC BankTuranAlem, JSC BTA Ipoteka

- Fitch Ratings has affirmed "B-" Stable rating for JSC Tsesnabank

Please, note that information provided in the current document is based on the data from different sources including published announcements made by various state authorities and other organizations.

The majority of information contained herein has been extracted from different publications released by the National Bank of Kazakhstan, the Agency of Statistics of the Republic of Kazakhstan, the Agency of the Republic of Kazakhstan for regulation and supervision of the financial market and financial organisations and official web-sites of Kazakh banks and none of the managers or

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Appendix: Major indicators of commercial banks*

| | Assets | | Capital | | Loans to customers | | Deposits | | Retail deposits | | Provisions | |
|-----------------|-------------------|------------|-------------------|------------|--------------------|------------|-------------------|------------|-------------------|------------|-------------------|-------------|
| | 01.01.08 | Dec/Nov | 01.01.08 | Dec/Nov | 01.01.08 | Dec/Nov | 01.01.08 | Dec/Nov | 01.01.08 | Dec/Nov | 01.01.08 | % of loans |
| KKB | 22 522 680 | 3,0 | 2 228 495 | 3,2 | 18 392 376 | -0,8 | 6 946 503 | 9,5 | 2 532 380 | 2,7 | -1 661 143 | -9,0 |
| BTA | 21 970 993 | 0,0 | 3 353 649 | 3,2 | 17 314 544 | 3,6 | 4 735 989 | -3,5 | 2 162 771 | 3,4 | -909 635 | -5,3 |
| Halyk | 13 000 739 | 7,1 | 1 172 041 | -1,5 | 8 772 561 | 4,6 | 7 556 624 | 11,7 | 2 888 624 | -1,6 | -562 451 | -6,4 |
| Alliance | 9 890 250 | 1,0 | 1 291 595 | 1,2 | 6 971 729 | -1,8 | 1 917 508 | 2,3 | 808 529 | -3,2 | -360 886 | -5,2 |
| ATF | 8 233 252 | -5,2 | 654 048 | -2,6 | 6 286 596 | -0,5 | 3 026 107 | -2,4 | 1 152 026 | 5,9 | -184 081 | -2,9 |
| Centercredit | 7 306 296 | 0,6 | 580 639 | 3,9 | 5 336 969 | -2,6 | 2 536 777 | -2,0 | 1 124 707 | 4,3 | -244 669 | -4,6 |
| Temir | 2 703 719 | 0,7 | 451 524 | 2,0 | 2 223 664 | -1,1 | 502 536 | 10,0 | 173 504 | 3,5 | -76 743 | -3,5 |
| Caspian | 2 135 400 | 1,6 | 246 998 | -4,1 | 1 590 228 | 2,6 | 643 103 | 9,1 | 260 960 | 7,1 | -97 964 | -6,2 |
| Nurbank | 1 692 579 | 2,9 | 320 858 | 5,8 | 1 238 334 | -0,6 | 393 638 | -19,1 | 87 594 | 10,9 | -62 940 | -5,1 |
| Subtotal | 89 455 908 | 1,5 | 10 299 847 | 1,9 | 68 127 002 | 0,8 | 28 258 785 | 4,2 | 11 191 095 | 1,9 | -4 160 513 | -6,1 |
| Other banks | 7 421 400 | 1,0 | 1 503 545 | 2,8 | 3 879 236 | 0,3 | 4 124 592 | 3,6 | 819 263 | 2,7 | -129 534 | -3,3 |
| Total | 96 877 308 | 1,4 | 11 803 392 | 2,0 | 72 006 238 | 0,8 | 32 383 378 | 4,1 | 12 010 359 | 1,9 | -4 290 047 | -6,0 |

* Source: commercial banks financial statements and KKB estimations